

Economics

PRINCIPLES AND PROBLEMS

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BASED ON THE ORIGINAL TEXT BY
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PREFACE TO THIRD EDITION

More than ten of the country's most momentous years have now elapsed since the appearance of the last edition of *Economics: Principles and Problems* by Lionel D. Edie. While the events of this period have, of course, made much of the book's textual matter obsolete, the general viewpoint and approach as outlined in the prefaces to the earlier editions are perhaps even more to the point today than when they were written. The present authors therefore have conscientiously attempted to carry on the spirit and tradition of the earlier editions despite the drastic textual revision called for by present conditions.

Some of the changes and additions in this edition which the authors believe to be most significant are:

(1) A new treatment of value and price, with special attention to oligopoly and monopolistic competition.

(2) An even closer tie-up throughout of economic principles and problems.

(3) Greater emphasis on the role of government in economic affairs.

(4) Greater emphasis on taxation, public expenditure and public debt, and deficit financing.

(5) New chapters dealing with risk, insurance, wartime economy, unemployment, and trends in international trade.

(6) Less attention to formal history of economic and cultural development in order to permit inclusion of certain of the above subjects.

(7) Considerable rearrangement of the contents and enlargement of the book.

In tracing economic developments by the use of statistical data, the authors have in general attempted to include the latest figures available. However, where the inclusion of figures for the current war would obscure the principle or confuse the reader, they have been avoided. For example, it would obviously be misleading to attempt to illustrate the working of effective competition by the use of data drawn from a system of rationing, or to try to portray trends of industrial development by drawing on experience with the administration of priorities.

In conclusion, the present authors wish to make it clear that, although they have attempted to prepare a worthy successor to the earlier editions by Dr. Edie, they accept full responsibility for all statements and any errors. They also wish to take this opportunity to express their appre-

ciation to their wives for their encouragement in the preparation of the manuscript and for their assistance in proofreading; and to their secretarial staff for helpful and efficient services in the typing of the manuscript.

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PREFACE TO SECOND EDITION

The revision of *Economics: Principles and Problems* has been more thorough and extensive than is usually attempted in revisions of general economics works. In the present case the revision has aimed not merely at bringing up to date the statistical data but also at amending and clarifying the theory.

Inasmuch as the realistic approach of the first edition seemed to appeal strongly to many readers and teachers, the emphasis upon realism has been preserved. However, to a greater degree than in the first edition, I have endeavored to go beyond factual foundations as such and to bring out the interpretation and significance of data. The objective has been to use the realistic background of economic life as a vehicle for developing principles and methods of thought. This should enhance the teachability of the whole treatment.

I have always doubted the wisdom of trying to teach economic theory as an abstraction to students at a stage of experience which has not permitted their acquaintance with the actual processes of economic life. Without a fairly good comprehension of what goes on in the daily work-a-day world, the student is not in a position to profit much from the theorizings of economists. The greater the vacuum of factual knowledge, the less the significance of principles. It is an out-moded pedagogy which assumes that memorizing a mass of so-called economic laws and generalizations is true education in economics.

Most of the economics textbooks presented to the college student today follow practically the same lines of exposition as prevailed in the literature 50 to 100 years ago. A few illustrations give a modern flavor, but the core of the argument is the same. Nevertheless, outside of the textbooks there have been countless studies and adventures of research which constitute in their grand total a body of invaluable information on economic life. I have endeavored to bring the student into contact with these studies which are in a real sense the frontier of economic thinking. This endeavor is not to discard the work of the past as such but to use it as a foundation on which to analyze the machine age and to improve our insight into the great economic problems of the contemporary period.

In the task of revision, I have received assistance particularly from Benjamin P. Whitaker, Ph.D., formerly instructor at Yale University and at present consultant in taxation for the Brookings Institution, and am much indebted to him for painstaking improvements and criticisms on a majority of the chapters. The chapters on historical background have received special attention by V. B. Chamberlin, Associate Professor of

Economics, Lewis Institute. The chapters on banking had the benefit of the careful criticism of Ernest R. Shaw, Ph.D., who is engaged in private investment and economic analysis. The material on agricultural problems owes much of its revision to the assistance of Professor A. C. Gubitz of Ohio University. I wish to express appreciation not only of the cooperation of these men but also of the cooperation of many others who have taken a helpful interest in offering suggestions and comments.

LIONEL D. EDIE

PREFACE TO FIRST EDITION

The purpose of this book is to provide an introduction to economics for university students and general readers. This purpose involves a statement both of orthodox economic principles and of modern economic developments. The contemporary generation of economists have extended the science beyond the boundaries reached by earlier economists, and it is proper that these extensions should be integrated with the main body of traditional economic thought.

Although many new tendencies are included in such an undertaking, nevertheless there is no intent to discard or to slight the great contributions made by classical and neo-classical economists. Their contributions are the foundations upon which must be built whatever additions and extensions modern growth may require. Our heritage of economic thought, in spite of many errors and fallacies, offers the most reliable basis from which to project whatever is new and worth while in contemporary economic thought.

The task of merging new with old viewpoints affords many problems for dispute among economists. In a purely critical treatise, to be read only by economists, it would be appropriate to argue each disputed point. But in an introductory textbook in economics, this controversial treatment could only lead to confusion and bewilderment among students. Accordingly, the plan of the writer has been to state as clearly and coherently as possible the content of economics when the newer developments are integrated with the older traditions of the science, without complicating the study by technical controversy over disputed issues.

A survey of economic science at the present time reveals a vast fund of research in particular problems, and a literature of countless monographs, technical articles, special volumes, and scientific reports. This fund of material has never found its way into the main body of economic theory. The textbooks state the classical principles of economics. The monographs and technical articles state the findings of current research. Between the two lies a chasm. But this separation is neither necessary nor desirable. The bodies of thought should be brought together; they should be cast into a unified whole.

No attempt has been made to build an entirely new system of economic thought. System building has had its part to play in the past, but for the present study the creation of some new system of thought has seemed unnecessary. It has seemed sufficient to endeavor simply to integrate the many separate branches of economic investigation, and to unify the growing content of the science. It has been assumed that the

subject matter and the points of view possess a fundamental solidarity and unity.

The task of sifting the material of modern research through one mind involves a very wide field of study, and the writer can scarcely claim to have absorbed completely the research in all fields. In spite of inevitable limitations, however, it is hoped that the main content of the new material has been assimilated, and made a part of the treatment.

As the title implies, the book deals with problems as well as with principles of economics. The problems are not merely "cases," such as are employed where the so-called "case method" is in vogue. Rather, they are actual economic issues of national or international concern. They are basic public problems of the present age.

Some of the salient features of the new material and of the new approach to the subject may be formulated as follows:

1. The presentation of the historical background of economic society has been influenced by the trend of the newer historical and anthropological research.

2. Quantitative methods supplement qualitative, and necessitate the frequent use of statistical measurement.

3. A factual and descriptive content is read into the theories and principles.

4. The relationship between a more or less constant human equipment of emotions, capacities, etc., and a highly variable economic culture is emphasized. The psychological presuppositions are brought into line with modern psychology. The method of treatment does not lead into a theoretical analysis of psychological terms, but depends upon an account of how human nature reacts to its economic environment. Economic behaviorism seeks to discover exactly what men do under the stimulus of given economic circumstances.

5. Institutional growths rather than immutable motives, inexorable laws, and a fixed social order, are looked upon as governing factors in the economic conduct of communities.

6. A frank ethical concern for welfare and well-being is adhered to, instead of an assumed but futile neutrality on the ethical implication of all questions.

7. The "money economy," and the relations between pecuniary and technological performance constitute threads of analysis running through all phases of the subject. Economic institutions reflect the "state of the money arts" as well as the "state of the industrial arts."

8. The tentative nature of generalizations is stressed, rather than the finality of dogmatic laws. Principles are regarded as hypotheses or inferences, to be tested by experimental and statistical science.

In a treatise where current statistical data play so important a part, the permanence of the work presents a peculiar problem. Data which are now up to date may be considered out of date five or ten years hence. The writer of a text in pure theory faces no danger that charts and fig-

ures will become out of date, because he makes no use of them, or at most does so sparingly. But in a quantitative treatment, revision of material is more necessary. Recent data are more desired than remote data. But although data may change and statistics may require revision, nevertheless, *the fundamental thing is the whole approach to the science which underlies all data and statistics.* The method, the content, the body of principles, are the aspects of the treatment which have permanent value. However temporary some of the data may be, it is the significance of the data, of the method of using it for developing the science of economics, and of the meaning which it supplies for the theories of economics, which has the qualities of permanence.

At present, economics is flooded with the piecemeal literature of the many-sided developments of the science. Out of this inchoate mass, a synthesis has been made. The new has been consolidated with the old. Widely diffused data have been assembled and interpreted. The presentation has endeavored to keep the style, the outline, and the selection of material, in a form suited to place modern economics within the reach of the student and the general reader. The purpose has been to make the introduction to economics teachable and understandable, as well as comprehensive and fundamental.

The writer wishes to express deep appreciation of suggestions and criticisms made by all those who have taken an interest in the preparation of the volume. He is indebted particularly to Dr. U. G. Weatherly of Indiana University for suggestions on some of the more important chapters of the work. Professor Seba Eldridge of the University of Kansas has read the entire manuscript, and has offered invaluable criticisms of form and content at every stage of the treatment. My wife has collaborated on the entire work, and has been my main reliance in securing clarity of thought and expression.

LIONEL D. EDIE

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PART I
A PANORAMIC VIEW
OF THE
ECONOMIC SYSTEM

THE ECONOMIC PROBLEM

Economics covers a field of study which is broad in scope and varied in content. On all sides, we see farmers raising and selling crops; lumbermen growing and selling lumber; miners extracting and selling minerals; manufacturers making and selling goods; bankers receiving and disbursing money; governments performing services and levying taxes; tradesmen and brokers exchanging goods, stocks, and bonds; insurance companies, importers, exporters, professional men, and the like, all carrying on business. What are the purposes of all these activities? How are they interrelated, coordinated, and controlled? What principles underlie them? These are some of the general problems of economics.

We may define economics as the science which deals with the goods-producing and goods-using, the money-getting and the money-spending, and the want-expanding and want-satisfying activities of man.

Economic activity and human wants. The driving power behind all economic activities arises from the wants or desires of human beings. Every individual wants food, drink, clothing, and shelter to keep alive and comfortable. Beyond these things, he wants home comforts, convenient transportation and communication, social prestige, education, advancement, political and business prestige, and some assurance of his future well-being.

In fact, no limit can be placed on the intensity, scope, and variety of human wants. They expand in an ever widening circle. As soon as the desire for simple food is satisfied, the individual wants more elaborate food. When he acquires coarse clothing and rude shelter, he immediately feels the want for better clothing and shelter. Thus, the desires of individuals constantly multiply. Man forever reaches out for more and better things for his enjoyment and gratification. Human wants always tend to run ahead of the available means for their satisfaction.

In the modern world, the immediate means of acquiring the goods and services necessary to satisfy human wants is money. What the individual wants is available only at a money price. He satisfies his wants to the extent that his money enables him to buy the goods and services needed. Thus, the individual comes to look upon money as the end and aim of existence. His desire for physical goods and services is commuted into the desire for money. His activities are directed to money making and money spending and only indirectly to making and using goods. The laborer in the factory, or the farmer on the farm, is spurred into activity by the immediate lure of money gains, even though his ultimate objective is the acquisition of goods and services for the satisfaction of his wants.

In a larger sense, behind the striving of individuals for money and the things money will buy is the human craving for individual and social improvement, higher standards of living, and the attainment of greater self-expression and realization. We stop short in our analysis of the drives to economic activity if we fail to take into account those intangible and imponderable aspirations which provide the impulse to an ever advancing scale of individual and social well-being.

Utility and consumption. Goods and services are the external things which the individual acquires and uses in the satisfaction of his wants. They provide the contact between the individual and his environment. It follows that the goods and services possess a quality or power which is essential to the satisfaction of human wants. *To this quality or power of goods and services which enable them to satisfy human wants we give the name "utility."*

Utility arises from the relationship between an individual, and goods and/or services. This relationship may be based objectively, as above, on the quality or characteristic of the good or service, or it may be based subjectively on *the valuation or estimate which the individual places on a good or service as a means to the satisfaction of his wants.*

Consumption includes all the activities and processes involved in the satisfaction of human wants. It may be considered subjectively or psychologically as the gratification or enjoyment derived from the destruction of utilities. It is the satisfaction of wants by the appropriation of goods and services.

Consumption may also be viewed as a physical process of using up tangible commodities. It consists of the destruction, through use, of loaves of bread, of yards of cloth, of pairs of shoes. Consumption may also be conceived of as the spending of money income. The pattern of consumption is set by the amount of money one has to spend and how one decides to spend it. Or, finally, consumption may be considered as the process of building human personality and developing community well-being. It may lead to vice, poison, and decay; or it may lead to character, health, and progress. All these views are essential for an adequate conception of the meaning of consumption.

Arising out of consumption so considered is the concept of standards and planes of living. The *plane of living* is determined by the amount of goods and services which individuals or groups actually enjoy. The *standard of living* is an "ideal" and represents the goods and services which individuals or groups might wish to attain and enjoy. The plane of living is an actuality; the standard of living may or may not be achieved in actual experience.

Wealth and economic goods. Before anything can become a good, someone must have a desire to enjoy it. Refuse, barren rock, ice at the North Pole, obnoxious weeds—these are not economic goods because they are not wanted, they satisfy no desire, they have no utility.

But scarcity must be coupled with utility before anything becomes an economic good. Limitation of supply is essential. The sunshine and the

rain, the air and the wind, the water of the ocean and the sand of the desert, all may have utility, but the supply under ordinary circumstances is unlimited. There is no scarcity, and where there is no scarcity there is no economic good.

Such unlimited goods are classed as *free goods*. Both economic goods and free goods have utility, but both do not have scarcity. Only a limited fraction of the physical universe can be called economic goods.

In addition to having scarcity and utility, economic goods are always assumed to be possible of *ownership* or *control* by man. The moon has scarcity and utility, but it is beyond human control; consequently, we would not classify it as an economic good. The essential characteristics of economic goods are *scarcity*, *utility*, and *possibility of human control*.

Wealth, as the term is technically used, is synonymous with material economic goods. Services are economic goods, but they are not material; they may be considered as means to wealth rather than as wealth in themselves. Wealth may be owned either by private parties or by the government. Government-owned oil lands or forests possess both utility and scarcity. They are just as much wealth as the wells or forests of private owners. The national wealth is the aggregate of the economic goods owned by individuals and by the government.

Often the line between economic goods and free goods is not hard and fast. For instance, air is said to be a free good, but this is not true under all conditions. A renter who lives in the top story of a city apartment house pays higher rent than the parties living on the ground floor because the fresh air and the sunshine at the top are superior. In other words, there is a scarcity of fresh air at a particular time and place; and, under those conditions, air becomes an economic good. Water is plentiful, but scarcity of water available for home use leads to the installation of the water meter. Water in the home is an economic good in the modern city, but it was not an economic good for the pioneer who dipped as much as he pleased from an inexhaustible spring. Under modern complexities of living, free goods tend more and more to pass into the category of economic goods because they become scarce with reference to some particular time or place. Scarcity is not a fixed and eternal quality but a changing quality, reflecting every modification of economic institutions.

In popular thought, money is confused with wealth. A wealthy man is one who is supposed to be worth a great amount of money. Frequently our multi-millionaires are measured by the dollar sign. Our ambition appears to be to make as much money as possible. But it must be obvious that money is important chiefly because it gives command over wealth. People strive with all their might to gain money because of what the money will buy. But a man would starve to death if surrounded only by bank notes or gold coin. Money is a universal means of purchasing power. With it, one can obtain the desired goods and services. But the money itself is important as a means rather than as an end.

Although money is not identical with wealth, nevertheless economic goods are distinguishable from free goods by the fact that the former can

command a money price whereas the latter cannot. Water becomes an economic good just as soon as one can sell it to a buyer and obtain money in exchange. The pecuniary test of wealth is the ability of a good to be sold for money. And the amount of the wealth, in the pecuniary sense, will be the amount of money offered for the good. If a ton of brick is worth \$15 and a ton of platinum is worth \$1,000,000, the latter is vastly the greater amount of pecuniary wealth. From a physical standpoint, it is only a ton of wealth in either case. But in the money economy, the amount of money for which a good will exchange is the measure of the wealth which it represents. The more money the good can command in exchange for itself, the more wealth it represents.

But neither the view of wealth as economic goods nor the view of wealth as a pecuniary sum is an adequate conception of wealth. To make it adequate, we must introduce the social point of view. From a social standpoint, the student who views our skyscrapers, our hundreds of millions of tons of coal, our hundreds of billions of dollars of national wealth, inquires: Does all this build character, health, and happiness? Wealth is not merely tons of pig iron but the means of social well-being. Wealth is not the almighty dollar but potential human welfare. The acid test of wealth is the human test; and, unless the output of factories and mines and the accumulation of gold and silver build healthy and happy laborers and wise and noble consumers, there is no wealth worthy of the name.

The necessity for labor. Because the things we desire are scarce, it becomes necessary to exert ourselves if we are to obtain them. The exertion which individuals put forth may be mental or physical, but whichever it is, it is labor. Some of this effort is enjoyable for its own sake, much of it is not enjoyable under present conditions. Most of modern labor would never be done if the joy of doing it were the only inducement. There must be some strong ulterior reward to pull men into sustained toil. This ulterior reward is the satisfaction of wants.

Economics investigates the conditions governing the growing of wheat, the manufacturing of flour, the baking of bread, the mining of coal and iron, the transportation of copper and steel, the construction of bridges and buildings. Nature contains certain resources. Man attempts to appropriate these resources for his own sustenance and enjoyment. He wrests raw materials from nature, fabricates them, transports them, consumes them. *Economic endeavor aims to acquire from the resources of nature the requisites for the satisfaction of human wants.*

Although in a fundamental sense economic activity reduces itself to the appropriation and fabrication of goods and products, these activities are carried on through the medium of money making and money spending. They move in terms of prices. Hence, *economics may be described as a study of human behavior from the standpoint of prices.* All business is a series of contracts of purchase and sale in which prices are quoted and paid, and money passes from hand to hand. The grower of wheat cares for the physical product only in so far as it will sell for an attractive price and bring him a money return. The laborer turns out a product only because of the